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Special meeting on external debt sustainability and development: lessons learned from debt crises and ongoing work on sovereign debt restructuring and debt resolution mechanisms

Summary record of the 9th meeting
Held at Headquarters, New York, on Tuesday, 23 April 2013, at 3 p.m.

President: Mr. Osorio ..... (Colombia)

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The meeting was called to order at 3.10 p.m.

Keynote address on the theme: "Gaps in legal and institutional structures for debt restructuring"

1. **Mr. Stiglitz** (Columbia University) said that the objective of any restructuring was to give countries and firms a fresh start. Excessive indebtedness was resulting in massive waste and suffering. Resources were destroyed in the battle over whose claims would be satisfied.

2. A bankruptcy regime must balance the need for orderly discharge and the need, under normal circumstances, for debts to be repaid. A good regime balanced ex post and ex ante efficiency and contained incentives to take risks. If restructuring was inefficient and costly, countries would be induced to delay it.

3. In many cases, lenders lent too much. Some Western banks tried to induce poor countries in sub-Saharan Africa to borrow too much, in order to create a debt crisis. Better accountability was needed for creditor behaviour, such as predatory lending. Banks often engaged in sovereign lending in the expectation that an International Monetary Fund bailout would follow. High-interest loans to poor countries could even replace concessionary loans. Many loans to developing countries were otiose debts, meaning that the lending itself was unconscionable. The lender was usually more financially sophisticated than the borrower, and creditors were typically compensated for risk in the form of higher interest payments.

4. There was no unified bankruptcy code. A quicker and more certain resolution process would reduce risk premiums, costly delays and macroeconomic disturbances. Sovereign debt restructuring and general bankruptcies had differing legal frameworks. While most countries had a domestic bankruptcy law and did not rely on private markets, a corresponding legal framework was lacking in the international arena. In domestic bankruptcy, there was a clear understanding regarding claimants' priorities. The debtor had limited funds, and an organized, orderly way of determining who would be paid was needed. However, in sovereign debt, there was no clear list of claimants.

5. When a country already had a primary surplus, a deep restructuring of debt could put it in a more advantageous situation. If a country was in a weak condition, it might spend a lot of money on debt servicing that could be better used to stimulate the economy, enhancing citizens' well-being. Many countries feared that restructuring could lead to limited market access, but, in fact, countries regained access with remarkable speed.

6. Restructuring involved significant short-term costs. Contracts had to be rewritten; distributive conflicts could be magnified and credit flows interrupted; bankruptcy could become widespread. But realignment of the exchange rate, where appropriate, and debt restructuring, especially deep restructuring, yielded even larger long-term gains. Shallow restructurings could result in years of turmoil and the need for further restructurings. What was needed was a mechanism that did not impose excessive penalties for restructuring. Recent bilateral investment treaties had made things much worse.

7. Market solutions alone would not work. Legal frameworks were important because many stakeholders were affected. There were large conflicts of interest among different claimants; disputes about valuations; coordination problems across contracts; and a variety of public goods problems. Hence, the court's involvement was needed to ensure reasonably fair treatment of all parties. Collective action clauses, based on the expectation that market solutions would work, were not adequate.

8. Development of credit default swaps meant that some parties to debt restructuring discussions had no stake in the outcome or hoped that there would be no outcome, because they could buy insurance against an outcome or gamble on a bad outcome. The interests of the parties at the table were thus not necessarily coincident with anyone's real interest. That had destroyed the effectiveness of the old bargaining system. Bonds that were linked to Gross Domestic Product (GDP), known as GDP-linked bonds, were an innovation that helped align incentives, so that creditors had an interest in seeing borrowers do well. However, financial markets had resisted that improvement.

9. A world bankruptcy organization was needed. A sovereign could then initiate a resolution, followed by a stay in litigation provision for lending into arrears and a temporary exchange of capital controls. The sovereign would propose a restructuring, and those who felt they were being treated unfairly could submit

counterproposals. A bankruptcy court would rule on the proposals.

10. In the meantime, an intermediate solution was needed that recognized the importance of imposing capital controls or exit taxes in the event of crises. There should also be mutual recognition of bankruptcy laws and procedures to resolve jurisdictional conflicts. The sovereign would propose an alternate resolution, and a mediation service would help evaluate the consequences of various resolutions proposed. A set of norms was needed to define which debts were otiose, which debts should be forgiven and other issues.

11. The experience of Argentina showed that while restructuring was costly, failure to restructure might be more so. Restructuring had led to a period of very strong growth in Argentina that had ended only with the global financial crisis of 2008.

12. The perspectives of financial markets must be treated with caution during restructuring discussions. Financial markets had a vested interest, but were only one of the parties. Their excessive lending had created the problem in the first place.

Panel discussion on the architecture for debt restructuring

13. **The President** said that given that more countries were having problems with debt, particularly in the developed world, proposals to create a debt restructuring institution might begin to receive more attention.

14. **Mr. Chodos** (Executive Director, International Monetary Fund) said that market solutions were ineffective because the claimants, who included bankers, intermediaries, investors, lenders, depositors and hedge funds, were too diverse, leading to a lack of alignment in interests. Hedge funds viewed their investments differently than did other claimants because they were not lenders or creditors in the structural sense and did not behave like other stakeholders. The problem of incentives must be at the centre of any new mechanism.

15. Too much emphasis was placed on market access in restructuring, in the mistaken belief that market access was a measure of the success of a restructuring. The repayment capacity of the borrower country should be at the core of any new mechanism.

16. In the past, outcomes had flowed from institutional framework design. However, it was necessary to work backwards from desired outcomes to avoid the problem of repeated restructurings. In Greece, for example, the debt-to-GDP ratio was worse than it had been before the restructuring. Further restructuring might be necessary.

17. **Mr. Humes** (Chairman and Chief Executive Officer, Greylock Capital Management, LLC) said that delays in launching restructuring discussions were a major problem. At a meeting in 2010, all attendees with experience in emerging markets had noted the unsustainability of Greece's debt profile. However, none of the Europeans present had been willing to acknowledge the issue.

18. Designing triggers might be helpful to call attention to problems at an earlier stage and start the restructuring process. The focus should be on the cost of debt servicing to the economy, rather than on the absolute debt-to-GDP ratio. While it was important to call attention to a country's unsustainable debt profile, care should be taken not to force a restructuring programme on a country whose economy was growing and generally functioning well.

19. While a sovereign debt restructuring could in theory address many problems, there might be practical difficulties in implementation. Some recent restructurings had been quite constructive, with the borrower recognizing their problem and alerting lenders in a timely manner. Creditors generally took note when they saw that a country was having difficulties, and they would take pre-emptive action. In the case of Cyprus, when problems had become apparent, stakeholders had gathered for discussions, rather than shrugging off responsibility

20. Since 2001, the ad hoc restructuring process had improved, with restructurings taking place more promptly. Despite problems in the case of Greece, such as holdouts in the official sector and the central banks, the burden had been shared. Such issues could be addressed through a mechanism, but how to deal with official sector creditors was a major question. Behind the scenes, current restructurings were going quite well. If a mechanism were implemented, there should be a focus on aspects that were going right.

21. **Ms. Nache-Zandstra** (Partner, Clifford Chance) said that in a context where bankruptcy was not a possible or favoured answer, and where reschedulings,

restructurings, buy-backs or repudiations were the norm, standstills could provide a platform for early engagement. Reducing delays by sovereigns in confronting unsustainable debt problems and encouraging an early response would thereby result in lower long-term costs. Standstills could also provide sovereigns and creditors with some financial stability to decide on a restructuring plan prior to default. Debtor-in-possession financing could be feasible in the context of a standstill.

22. Considered in conjunction with a legal stay, a standstill could prevent cross default and acceleration of obligations, as well as litigation. Corporate standstills had brought creditors together to work for a unified plan, something which did not always happen in the sovereign context on the basis of good faith negotiations. Standstills might also diminish uncertainty and contagion in circumstances where agreement as to the scope of a restructuring was not yet forthcoming. They could also create a framework for establishing a better set of priorities.

23. The scope of the standstill would have to be agreed. The corporate test of the debtor's inability to pay debts as they fell due could not serve as a trigger, because technically a sovereign could not become insolvent. Lack of debt sustainability was more important. There could be a deferral of interest payments only or a broader cessation of payments, and there could indeed be some situations where the debtor did not wish to stop making payments. The standstill could include a legal stay or litigation, or a waiver of certain events of default or acceleration rights. Standstills typically lasted 90 days in the corporate context, but some debtors might want to extend the period.

24. Other questions that should be considered included whether there should be triggers for termination of the standstill, if, for example, negotiations were not going well; what the scope of work should be during a standstill; and the extent to which the task of taking negotiations forward should be delegated to bondholders. One concern was that, aware of the possibility of a standstill, the debtor might be more likely to incur more debt during the period leading up to the escalation of its problems.

25. A standstill could trigger a credit debt swap; and there could be rating downgrade implications or implications for asset impairment of financial institutions' balance sheets too early in the process. The universe of creditors would change over time, and what that meant in practice was not known. There might be limits to the claims that could be made subject to a standstill. A standstill could become a reserved matter under a collective action clause or be subject to acceptance by a bondholder or an automatic trigger. A contractual solution would require considering bondholder committee technology.

26. It would be necessary to establish whether the membership of the bondholder committee would be limited to the largest holders or representatives of the retail sector; who would pay the costs of the committee that would move standstill negotiations forward; and what that committee's terms of reference would be. The more prescriptive the terms, the more difficult it could be to reach an agreement between debtors and creditors on the contractual mechanism. It was important to look at who was bound by the standstill, such as other creditor groupings, bank lenders, swap counterparties, multilateral banks and official sector funding sources.

27. Standstills had been considered, inter alia, by the International Monetary Fund, but the idea had not been implemented. It should be re-examined. Based on the current contractual framework under which sovereign debt was issued, it would be possible to look at voluntary standstills as an additional contractual element, but there were legal and practical difficulties.

28. The value of standstills in a liquidity crisis as opposed to a solvency crisis should be examined, as should the question of whether any deferral of payment under a standstill might have serious consequences for the debtor's continued market access. Countries might see standstill arrangements, even voluntary ones, as imposing unwelcome restrictions. Creditors might feel that the current system enabled them to engage with debtors on their own terms. A standstill might create an incentive for creditors to dump assets as soon as the trigger point was reached.

29. Other ideas in the contractual arena that could enhance sovereign debt restructuring included clarification of the pari passu provision, wider use of trustees to promote enforcement by a single entity and pro rata distribution of recovery proceeds. Financial institutions should give more thought to GDP-linked bonds. Instruments could be developed for sovereigns with interest and/or capital deferral options similar to

those as in the banking and insurance regulatory capital world, in order to provide more flexibility in delaying payments at times of difficulties.

30. **Mr. Buchheit** (Partner, Cleary Gottlieb Steen & Hamilton) said that until a transnational bankruptcy regime was in place, the sovereign debtor had no ability to demand that creditors restructure. It was assumed that all creditors would give debtors the relief sought under a restructuring. If a significant number declined to participate, the restructuring might have to be redesigned.

31. While a small group of holdouts might not pose a major financial threat, they were nonetheless an emotional issue for the debtor and the other creditors. The debtor would recall the bitter austerity imposed on the people of the country and the fact that other creditors had provided painful debt relief, while a holdout or holdouts demanded repayment in full and spoke of the sanctity of contracts. Lenders who had lent a hundred cents on the dollar or euro and accepted an arrangement to receive 50 per cent of that back would not look warmly upon a fellow lender who had paid only 30 cents for a claim and was now demanding and perhaps receiving a hundred.

32. Such situations could be addressed through positive or negative incentives. One response was to tailor restructuring to creditors' individual regulatory preferences and constraints. For example, optional features could include fixed and floating rate instruments, instruments that were exchanged at par and a choice between loans that were 100 cents on the dollar and others that were discounted, but had higher interest rates.

33. In some corporate restructurings, creditors were asked to take equity in lieu of their debt claim, with the possibility of an increase in value if the company did well. That could be replicated for a sovereign by providing creditors with a value-recovery instrument that would pay off if the debtor country experienced an upturn at some point in the future. Oil exporters that had done Brady bond transactions in the 1990s had given their creditors oil warrants committing to share benefits if the price of oil exceeded a certain level. Some debtors had offered collateral security for the new instrument. Brady bonds were nearly all collateralized for the repayment of principal at maturity. In other cases, the restructuring linked the new instrument issued to commercial creditors to payment performance of a loan to an official creditor.

34. One ubiquitous negative incentive in all sovereign debt restructurings was the explicit or implicit threat that holdouts would not be paid and would have to litigate for years, perhaps decades. Other approaches included focusing on the non-payment terms of a debt instrument, such as the waiver of sovereign immunity; submission to jurisdiction; or choice of governing law, rather than on the amount or date of payment. If such terms were changed in a way that diluted their value to the holder, the holdout's decision as to whether to continue with an amended instrument would be affected.

35. Collective action clauses, contractual provisions by which a supermajority of the holders could vote to restructure and have that decision be binding on all the rest, were common. Supermajority control of the process was a principal feature of corporate reorganizing statutes. Supermajority creditors would sweep along any dissident minority and remove the possibility of holdout creditors.

36. It was notoriously difficult to enforce a sovereign debt instrument against a sovereign. Sovereigns rarely kept assets outside their own jurisdiction in their own name, and the assets they did have, such as embassies and consulates, had special legal immunity. A holdout creditor would have little difficulty in getting a court judgment, but that was just a piece of paper. The court judgment gave no financial satisfaction unless an asset could be found against which to levy. Some creditors were still seeking assets against which they could levy after Argentina's default in 2001.

37. In May 2003, as part of the restructuring of 140 billion dollars of Iraqi debt, the Security Council had passed resolution 1483 (2003) immunizing all Iraqi oil and financial assets against all judicial process anywhere in the world, thereby letting holdouts know that they would find no asset against which to levy. It was the sole example of the international community acting to change the balance of a sovereign restructuring. The restructuring of Saddam-era debt stock had gone forward, and it had been savage for the creditors.

38. Sovereign debt restructurings should replicate the principal features of corporate bankruptcies. A decision must be taken as to whether restructuring was necessary and whether there had been a fair allocation

of the burden on the various creditor groups. In the sovereign context that was not easy, requiring a determination as to whether the degree of fiscal austerity that the citizenry and other creditors were being asked to bear was fair.

39. Supermajority creditor control of the process was a central feature of corporate bankruptcies and should be replicated in sovereign debt restructuring. The automatic stay, which meant that creditors could not resort to their normal legal remedies, should also be used.

40. He had suggested in a recent paper on Cyprus that perhaps Europeans who had a treaty through the European Stability Mechanism to provide financial assistance to eurozone member countries in trouble might consider something similar to what the Security Council had done in Iraq in 2003. The proposal was that if a creditor invited to participate in a debt restructuring supported financially by the European Stability Mechanism declined to do so, then for that creditor alone, the debtor's assets in the eurozone would be immunized from any form of judicial process. It was not an attempt to change the creditor's rights. The creditor could still get a judgment. However, it did change the ability to enforce against sovereign assets.

41. **Mr. Haley** (Executive Director, Inter-American Development Bank), speaking in his personal capacity, said that the international financial architecture had not kept up with changes in the global financial system. In an earlier era, the sovereign debt issue would have been resolved simply; creditors would have sent in the guns and taken over the customs house.

42. In the current, post-Bretton Woods era, with the erosion of the consensus that had existed in the decades after World War II, countries had sought increased financial integration. During the Bretton Woods era, balance of payments problems had typically been matters of 2 to 3 per cent of GDP or slightly more. Under current conditions, balance of payments problems were financial sector crises. The crises were much larger because the problem was one of converting stocks of assets, rather than flows, and stocks of assets could be far greater. Recent crises, which had involved 10, 12 or 15 per cent of GDP, resembled bank panics or bank runs, during which investors rushed anxiously to the central bank looking to exchange domestic assets for foreign assets.

43. The burden of adjustment on countries in those crises was correspondingly much larger. However, the International Monetary Fund, which had been designed for the problems of an earlier era, had responded by attempting to achieve a judicious balance between financing and adjustment. It was now in the position of trying to catalyze private capital through its lending. When that was effective, as arguably it had been in Brazil just over a decade ago, it avoided economic and social disruption, but when it did not, there were more fundamental problems associated with insolvency as well as illiquidity, and the result could be a protracted downturn. The adjustment, compression of domestic absorption, private spending, investment and government expenditures required to make the balance of payments balance was correspondingly greater, and, while the Fund did not want to engage in such compression, it lacked the instruments to do anything else.

44. One possible response would be to endow the Fund or some other international body with the resources to become the global central banker. In the face of a panicked bank run, it would provide liquidity with good collateral and appropriate safeguards. However, there was no international consensus, and it was not necessarily the right thing to do.

45. A second option was to broaden the definition of adjustment beyond the Bretton Woods domestic absorption to include the adjustment of private sector claims on the sovereign. Sovereign debt owed to other sovereigns could be rescheduled or reduced in the Paris Club, but the international architecture lacked a meaningful way to promote the timely, orderly restructuring of private claims.

46. The Fund had advanced the sovereign debt restructuring mechanism a decade earlier to create another instrument for improved management of global financial crises, and, in doing so, had tried to replicate several key features of domestic bankruptcy law. Domestic bankruptcy law allowed for a reduction in debt load to avoid perverse incentives created when adjustment policy benefits flowed predominantly to foreign creditors. At the domestic level, debt discharge was conducted under the oversight of a judge balancing many different interests, and all relevant stakeholders were included. The key issues were debt sustainability and the degree of fiscal adjustment that could be sustained. The private sector had objected to the initial version of the sovereign debt restructuring mechanism,

recognizing that when the Fund itself was a major creditor to a sovereign undertaking debt restructuring, it could not provide disinterested advice to its members. As a result, the Fund's role in trying to determine, force or guide a debt discharge had been eliminated.

47. Another objective of the sovereign debt restructuring mechanism was to limit asset seizures by promoting standstills. That provided breathing space in which prudent policies could be put in place, preserved asset value for creditors and increased the size of the pie so that the citizens of the country did not have to undertake excessive adjustment burdens. The sovereign debt restructuring proposal had been blocked a decade earlier.

48. Most market participants would argue that voluntary debt restructuring over the past decade had been relatively swift, with a high degree of participation. With the exception of Argentina, it had been devoid of litigation. By making voluntary exchange offers conditional on minimum participation thresholds, the debtor could help eliminate collective action problems related to drawing creditors into a consensus, provided that neither the haircut nor the probability of a successful hold-out was too high.

49. In the last decade, the success of collection action clauses in international bond markets had been remarkable, but outstanding problems remained. A creditor holding a bond subject to a collective action clause had little or no incentive to accept a haircut without some assurance that other creditors were prepared for a reduction of their claim.

50. Some observers believed that the voluntary approaches developed over the past decade, while not perfect, represented a significant improvement over what had been feared a decade ago, while others believed that deadweight losses remained. To achieve voluntary restructuring, the threat of coercive measures must be present. The question was whether a system of rules for debt restructuring would help reduce uncertainty and create an environment similar to that which existed at the domestic level, in which many restructurings were done in the shadow of the courthouse. Both sides then knew that if they did not engage in a voluntary restructuring, the dispute would go into the formal bankruptcy system. That eliminated many unnecessarily complex negotiations and allowed parties to achieve a settlement quickly.

51. It made sense to explore the question of whether a more formal structure such as a sovereign debt restructuring mechanism was required. While many legal innovations over the past decade had helped promote voluntary, orderly restructurings, there would be, for each innovation, other innovations that neutralized or limited the applicability of the first one, making future restructurings more lengthy and difficult. The relative speed and ease of voluntary restructurings over the last decade might have had more to do with the enabling environment than with the inherently positive nature of the restructurings themselves.

52. Delays were costly. They reflected an attempt to gamble for redemption and the desire to put off a bad restructuring outcome and associated costs because of the prospect of a bailout. But if the official sector was also concerned about the costs of bankruptcy, they might, in the absence of an orderly restructuring framework, provide the bailout too quickly and easily, thereby encouraging debtors to gamble for redemption.

53. **Ms. Young** (Belize) said that because her country had declined commercial credit and refused the cocktail of austerity, higher taxation and unbridled privatization offered by the International Monetary Fund that had already shown itself to be a failure, Belize had lacked a financial institution support mechanism. Belize had requested only a partial guarantee of its restructured debt, collateralized by the future flow of official sector oil income, but had received only a demand to implement policies that would have amplified the impact of the recession and driven more Belizeans into poverty. According to media reports, the Fund was about to demand that the United Kingdom practise *less* authority, rather than more. Usable credit facilities that were available to developed countries should have been available to Belize as well, but the country was simply too small to save. The balance sheets of the World Bank, the International Monetary Fund and other such institutions should be able to provide further support to the fragile economies of small, middle-income States.

54. Emerging economies deserved to have a greater voice in the operation of the multilateral financial institutions, and solutions must be tailored to small States. The post-2015 development framework must reward conduct conducive to the survival of the planet. Small States needed not only an "emergency room", but also a fiscal "recovery room". The volatility of the

economic fundamentals of small States, including GDP, tax revenue, exchange rates and terms of trade, must be addressed. There should be discussion of debt structures that made public finances less susceptible to externalities; indexing repayment of principal and interest to the exports of small States; commodity prices; stage of development; terms of trade; rate of economic growth; natural disasters; and inescapable business cycles, such as recessions. Global economic management must place limits on unscrupulous lenders. An important feature of the Great Recession had been the unchecked greed of credit markets.

55. **Ms. Isella** (Switzerland) said that the lack of a framework to support the orderly restructuring of sovereign debt was a notable gap in the international financial architecture. Such a framework would lower the cost of sovereign defaults and lead to more prudent lending, thereby lowering the risk of excessive indebtedness. The framework should remove incentives to hold out and improve the predictability of the process and the flow of information between debtors and creditors. It would probably include standardized language for collective action clauses and provisions on exit consents, aggregation clauses and minimum participation thresholds. While the framework should render restructuring easier to manage, it should in no way make it more attractive.

56. **Ms. Hay** (New Zealand) requested clarification on how to choose the appropriate time to restructure. She wished to know how deep a restructuring should be if it was set to take place prior to default.

57. While the voluntary measures of the past decade had made a difference, more was needed. Further information on what steps could be taken at the international level and by whom would be appreciated. International consensus on a sovereign debt restructuring mechanism was difficult to reach. It would be helpful to know whether international measures should take the form of a treaty, whether an intermediate approach would be most effective, given the time that instituting a mechanism was likely to take, and what steps would be most effective at the current time.

58. **Mr. Humes** (Chairman and Chief Executive Officer, Greylock Capital Management, LLC) said that in the case of Belize, various officials had reached out to creditors and engaged in dialogue, resulting in a successful, speedy process. Many European countries that had implemented International Monetary Fund programmes had seen significant deterioration in health care and mortality rates, according to the media. The health care of the population should be paid for before settlements were made with other claimants. Contrary to popular stereotypes, financial sector representatives did not generally want to steal food from the plates of children. In fact, many had worked very hard to bring in the holdouts and tailor deals that addressed their needs.

59. **Mr. Buchheit** (Partner, Cleary Gottlieb Steen & Hamilton) said that the objectives of a sovereign debt restructuring mechanism were gradually being replicated on a case-by-case basis. The recent Greek restructuring, the world's largest sovereign debt restructuring, had affected €206 billion of debt in the hands of private sector borrowers. It had turned out that 93 per cent of Greek debt stock was governed by Greek law, and the Greek parliament had therefore been able to pass legislation allowing a supermajority of the holders of the instruments to decide on the restructuring. The debt restructuring efforts had tried to replicate the way in which a corporate bankruptcy was administered and how a sovereign debt restructuring mechanism would have been administered had it been in existence at the time. The percentage of holdouts had been very small.

60. **Mr. Chodos** (Executive Director, International Monetary Fund) said that the outcome was the most important thing. The question was whether the Greek restructuring had been sustainable or whether further restructuring would be needed. Structurally, the Greek example had indeed been very successful, but in substance it had been rather unsuccessful, perhaps because matters other than repayment capacity had been a priority in its design. Whatever the structure used to channel the process institutionally, it must result in increased growth, without which the debt structure would not be sustainable. If the structure of the institutional framework did not guarantee the desired outcome, then repeat restructurings would be required.

61. **Mr. Schuldt** (Ecuador) requested further information about the Greek restructuring, including the subsequent restructuring of the national economy and the financial market that had taken place. Also helpful would be additional comments on distinguishing between different types of creditors and

additional measures that could be adopted with regard to otiose or legitimate debt.

62. Measures taken by Ecuador had led to a savings of $7 billion and a significant decrease in the allocation of resources for debt repayment. Money saved on debt servicing could be reallocated to economic growth and recovery, in keeping with the country's needs. The new statutory mechanism and the proposals for a world bankruptcy court should take that issue into account.

63. **Mr. Hawezy** (Iraq) said that his country's restructuring had been described as disastrous for lenders. That issue had been inherited from the former regime. In future, lenders must understand the need for better engagement and oversight. In Iraq, the money had fuelled wars with neighbours and enabled a dictator to continue with his military programme. Before lending hundreds of billions of dollars, countries and private institutions should ask where the money was going. Lenders must be engaged and find out if the money was really serving a good purpose, because there was the risk of not getting paid back. The situation had been a disaster not only for the lenders, but for the region and for Iraqis. Despite efforts by the Fund and the World Bank, not every country and institution had cancelled their debts.

64. **Mr. Humes** (Chairman and Chief Executive Officer, Greylock Capital Management, LLC) said that the private sector had shouldered its share of the burden in Greece. It had been brought in when it became clear that a 25 per cent principal haircut would not be workable. In the end, a 53.5 per cent haircut had been applied to the principal, and there had been an extension of maturities and a reduction of coupon, making that portion of the country's debt stock very manageable. Just before the deal was to be signed, however, the European Central Bank and all other central banks in Europe that had the same bonds as those being restructured took them out and did a swap, thus avoiding a haircut and leaving the country's debt burden problem unresolved.

65. The European Union had lent Greece €10 billion to repurchase private sector long-dated low coupon bonds to reduce its debt-to-GDP ratio to 124 per cent by 2020, while imposing only a slight burden on the economy. While that had provided a boost in the price of the secondary market, it was an absurd use of funding. A better use for a loan of that magnitude would have been to stimulate economic activity, thus helping the official sector to reduce its stock of debt.

66. The issue of otiose debt was very difficult. There had been some nuclear plant lending in the Philippines restructuring that was probably an otiose debt, but it had been cheaper to sweep it into the general restructuring. Accommodations must be made to make sure a restructuring was effective overall.

67. **Mr. Buchheit** (Partner, Cleary Gottlieb Steen & Hamilton) said that if Greece's debt stock was still unmanageable, that was no longer the fault of the commercial lenders. Greece had $31 billion in the hands of the private sector, down from more than €300 billion in 2010. That meant that 90 per cent of the debt stock had been written off or had migrated into the hands of the official sector. Discussion of further restructuring, if that was necessary, would happen in Brussels, not with private creditors.

68. The idea of a debt so repugnant that it could not honourably be assumed by a successor Government was a difficult and dangerous concept. All Governments saw their predecessors as guilty of some form of mismanagement. If a new Government had the option of disavowing obligations incurred by its predecessors, many Governments would do so.

69. There had been nothing subtle about the Saddam regime. Lenders had known precisely what he was doing. A strong moral case could be made with regard to the debt restructuring that had eventually occurred in Iraq, involving an 80 per cent cancellation of the nominal amount of the debt, or, in net present value terms, a write-off of some 90 per cent, that the creditors who had backed Saddam had made the wrong choice. Lenders did have a degree of responsibility before they advanced money to sovereigns and to particular regimes. If they could see that the money was being employed inappropriately, then lenders should be on notice that if there was a regime change, they might not get it all back.

70. **Mr. Haley** (Executive Director, Inter-American Development Bank) said that one way of thinking about the challenge ahead was to envision a spectrum, with a sovereign debt restructuring mechanism and an international bankruptcy organization at one end and voluntary restructuring at the other, and try to see if there was a middle ground. There could be a voluntary sovereign debt forum where informal debt restructuring meetings were held on an informal basis, akin to the

Paris Club. Over time, a body of know'edge and legal conventions would develop.

71. Debt discharge was a bargaining process between creditors and borrower. Adequate information flows and trust in the information provided by the other side might help to facilitate more timely restructuring. Private sector creditors and sovereigns could participate on a voluntary basis, while trying to replicate some of the important functions of the statutory approach.

Concluding remarks and closure of the special meeting

72. **The President**, summarizing the discussions, said that because the debt problem was now affecting the developed world, there were significant implications for global systemic risks. While the costs of restructuring were high, those of not restructuring were higher.

73. There was no analogue to domestic bankruptcy courts for international sovereign debt bankruptcy. Efficiency and equity required that changes be made to current approaches. Collective action clauses were not sufficient to address debt overhang in situations of low growth and rising risk premiums. In seeking a solution, it was necessary to recognize conflicts of interest, find a practical path and not set expectations too low.

74. *The President declared the special meeting closed.*

The meeting rose at 5.40 p.m.